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Room 5203
Internal Revenue Service
P. O. Box 7604
Ben Franklin Station
Washington, DC 20044

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Comments Re: Guidance on the Determination of the Section 4968 Excise Tax Applicable to Certain Private College and Universities (IRS, REG-106877-18)

Ladies and Gentlemen:

We are writing on behalf of Berea College, a Kentucky non-profit corporation and independent, liberal arts college located in Berea, Kentucky. Berea College ("Berea" or the "College") is a 501 (c) (3) tax-exempt organization. As of the 2018 Fall Term, the College had an enrollment of 1673 students (1645 FTE), all of whom are undergraduates.

Berea's Mission and Tax-Exempt Purpose

Since its founding in 1855, Berea has served young people primarily from Appalachia and Kentucky who cannot otherwise afford to pay for a college education. More than half of Berea's students are the first in their families to attend college. Berea is one of only nine federally recognized "Work Colleges" where students work as an integral part of the academic program, also earning money used to defray some of their direct costs of attendance.

Berea's mission and tax-exempt purpose are unique among the colleges and universities with substantial endowments, the income of which may be subject to the tax imposed by Code Section 4968 (the "Excise Tax"). Under its mission statement entitled "The Great Commitments of Berea College" (attached as Exhibit A) and guided by its corporate charter, Berea exists to provide a high-quality liberal arts education to students of all races, primarily from Appalachia, who have great promise and limited economic resources. Berea's charter

also provides that the spendable return from its endowment shall be utilized to provide tuition scholarships "so that no student admitted to the college shall be required to pay tuition."

Since 1892, no Berea student or their family has been required to pay tuition from their own resources. Unlike almost every other college or university in the United States, any student who can afford to pay tuition at Berea is ineligible for admission.

Berea's Financial Model

Berea's financial model, including its dependence on endowment spendable return in lieu of tuition payments, is radically different than most institutions that are enrollment driven and the practices of other heavily endowed colleges and universities. At many colleges and universities, tuition payments provide 70-80% of the revenue needed to support the unrestricted operating budget and additional students provide additional revenue. Since Berea does not collect tuition from its students, "tuition" is paid internally by the endowment spendable return which provides 70-80% of the revenue needed to support its unrestricted operating budget. Although Berea desires to provide access to more financially needy students, it must limit its enrollment because of this unique internally-funded economic model.

On September 13, 2016, Berea's Vice President for Finance, Mr. Jeff Amburgey, testified before the Subcommittee on Oversight of the House of Representatives Ways and Means Committee during a hearing on "Tax-Exempt College and University Endowments." Mr. Amburgey's testimony and his written remarks are included as part of the Subcommittee's report, which is attached as Exhibit B to these comments. This report outlines Berea's unique program, its financial model and reliance on endowment return to replace tuition, which is not collected from any student or family, utilization of Pell Grants, and state student financial aid. Mr. Amburgey's remarks end with the College's plea that "no actions will ever be taken to reduce the dollars available to fund Tuition Promise Scholarships for its students."

So then, by design, Berea College serves underprivileged students lacking the means to pay for a college education. Since the advent and availability of funds under federal student aid programs, most notably the Pell Grant program, beginning in 1976, a substantial majority of Berea students have been eligible for this form of need-based aid. More recently, Kentucky student aid programs, including Kentucky Tuition Grants (KTG), the College Access Program (CAP) and the Kentucky Educational Excellence Scholarship Program (KEES) have provided additional support for Kentucky residents enrolled at Berea. These monies come directly to the college under participation agreements with the U. S. Department of Education and Kentucky Higher Education Assistance Authority. These funds have enabled Berea to maintain its enrollment in difficult economic times and, in recent years, to expand the student body to its current size of approximately 1670 students.

Quite unlike the other private colleges and universities that may be subject to the Excise Tax, Berea uses its endowment principally as a tuition replacement fund. Regardless of how much or how little governmental scholarship and grant money is available, Berea's Tuition Promise Scholarship means that all of its students pay no tuition.

While the College believes that it is exempt from the Excise Tax imposed by Section 4968 based on the statutory text, it is concerned that part of the definition of "Tuition-Paying" contained in the proposed regulations at Section 53.4968-1 (a) (3) (ii) (C) will have the unintended effect of subjecting Berea to the Excise Tax. We are concerned also with the proposed regulations concerning the determination of "net investment income" and economic effects of the proposed regulations.

Comments Re: Proposed Regulatory Definition of "Tuition-Paying Students"

The text of Code section 4968 (b) (1) (A) provides certain criteria to determine what colleges and universities may be subject to the Excise Tax. It begins by stating that "an applicable educational institution is an 'eligible educational institution' (as defined in section 25A(f)(2)) if: **(i) it had at least 500 tuition-paying students during the preceding taxable year, . . .**"

Congress did not endeavor to define or qualify the phrase "tuition-paying students." Under the usual rules of construction, these words and the entire phrase have their common and ordinary meaning unless a specialized meaning is required by the statute which is not the case in the present context.

Nonetheless, the proposed regulations go beyond the statutory language to add the following additional criterion: "However, scholarship payments provided by third parties, even if administered by the institution, are considered payments of tuition on behalf of the student." This text goes beyond the plain text and meaning of Code Section 4968(b)(1)(A) which is limited to tuition paid by students.

The Explanation of Provisions provided for the proposed regulations under 26 CFR Part 53 (Reg-106877-18) are detailed and expansive, except for the inclusion of the text "However, scholarship payments provided by third parties, even if administered by the institution, are considered payments of tuition on behalf of the student." No rationale, statutory or regulatory references are offered in support of treating all third-party "scholarships" in the same way as payments of tuition made by students.

In addition, it is unclear whether the term "scholarships" in the proposed regulations is intended to include Pell Grants and other forms of federal and state student financial aid as well as non-governmental grants made on behalf of students. Treating these payments as tuition paid by students is inconsistent with the language of Code Section 4968, conflicts with the purposes of these grant programs, ignores economic reality and unfairly impacts Berea

while having no discernable effect whatsoever on the remaining institutions with substantial endowments that may be subject to the Excise Tax.

Likewise, it is uncertain whether the "scholarships" language is intended to affect institutions such as Berea, even when a substantial portion of such scholarships and grants are not being applied to tuition costs but, rather, to students' direct costs, such as room and board. This would be utterly inconsistent with the legislative history and statutory text of Section 4968.

The proposed regulations rely on Code section 25A(f)(2) pertaining to "American Opportunity and Lifetime Learning Credits" and its definition of "eligible educational institution" to describe an "applicable educational institution" under Code Section 4968. The effect of third-party payments is not discussed in this section and it cannot be used as authority for the proposed inclusion of "scholarships" or third-party payments in defining "tuition-paying students."

It is important to note the major impact of federal and state student aid in the context of higher education. In FY 2016-17, the Pell Grant program provided assistance in the amount of approximately $26.9 billion for the benefit of nearly 7.2 million students at 5,384 eligible educational institutions across the United States. Berea College and virtually every other college and university in America receives substantial support through though Pell. State student-based aid programs also make college education more affordable to students with financial need.

The socio-economic circumstances of Berea's students are such that it admits and educates a far higher percentage of students eligible for Pell Grants, other forms of need-based aid and state grants. The financial need of Berea students is, on the whole, very different from the student cohort at the other institutions which may be subject to the Excise Tax. Measured by the relative percentages of students eligible for Pell Grant assistance, Berea stands alone with a proportion of 98%. The next highest Pell participation rate among the likely cohort of Excise Tax-paying institutions is only about 23% and the average for this group of distinguished institutions is less than 16% (excluding Berea).

Under the complex methodology utilized by the Department of Education and the Free Application for Federal Student Aid (FAFSA), the economic situation of each applicant for financial aid (or their parents, if the student is still a dependent) is evaluated to determine their "Expected Financial Contribution" (EFC). This is the figure that each student (or family) is expected to contribute to the student's costs of attendance.

At Berea, 59% of its students in 2018-19 had a zero EFC. The FAFSA determination is that these students (or their families) have the ability to pay none of their college costs. It is hardly surprising then that virtually all of Berea's domestic students are eligible for Pell Grants and various other forms of federal and state student aid to help with their college

expenses. Even with this assistance, Berea's Tuition Promise Scholarships originating from endowment earnings provide more than 95% of tuition costs.

Berea's Endowment is an Asset Used Directly in Carrying Out Its Exempt Purpose

While the statutory text of Section 4968(c) concerning the determination of "net investment income" provides that it shall be determined under rules "similar to" the rules of Section 4940(c) regarding private foundations, this does not necessarily require the adoption of rules requiring taxation of net investment income when a college or university, like Berea, is completely reliant on substantial distributions from endowment returns to directly implement a core element of its tax-exempt purpose, providing tuition scholarships to all of its students. See also Section 4940(d) providing for the outright exemption of certain private foundations and Section 4940(e) allowing a reduction in tax based on qualifying distributions by such foundations. Berea's endowment is just as critical to its viability and student success as are the College's campus, buildings and classrooms.

Economic Effects of the Proposed Regulations

Pages 41 and 42 of the guidance on the proposed regulations includes the following statement: "The guidance provided in the proposed regulations also ensures that the excise tax liability is calculated similarly across taxpayers, avoiding situations where one taxpayer receives preferential treatment over another taxpayer for fundamentally similar economic activity." Page 22 of the guidance advances the premise that all "colleges and universities educate students and charge tuition as part of their primary exempt activities."

Berea's use of its endowment as a tuition replacement fund for all of its students is radically different than the tuition income model employed by virtually every other college and university in the United States. Berea's tax-exempt purpose, mission and financial model are completely dissimilar to those distinguished institutions which are believed to be subject to the Excise Tax.

Since none of Berea's students, or their families, pay any tuition from their own limited incomes or resources, the College has no "tuition-paying students" and should be exempt from the Excise Tax under the plain meaning of Code Section 4968 (b). The proposed regulations, by treating third-party "scholarship" payments as "tuition paid by students" is inconsistent with the intent of the statute and its language and fails to recognize that the economic (and educational) activity engaged in by the College is different, and markedly so, from other institutions with substantial endowments.

Requested Action

As written, the proposed regulations penalize Berea for serving low-income students and likely would result in an average annual tax liability of approximately $1,000,000/year,

based on returns over the last several years. This would represent a substantial diversion of resources from the spendable return on Berea's endowment, funds that are already being fully utilized to replace tuition that we will never collect from our students.

We ask that the Treasury Department and Internal Revenue Service reconsider the proposed regulations and strike the text under 26 CFR Part 53 (Reg-106877-18) which states: "[H]owever, scholarship payments provided by third parties, even if administered by the institution, are considered payments of tuition on behalf of the student[.]" and exclude any third-party payments, scholarships or grants from being considered as payments of tuition by a student for the purposes of Code section 4968. We ask also that rules adopted to determine "net investment income" be modified to reflect the different nature of a college endowment that is, effectively, a tuition replacement fund. Our economic model is different, and these changes will not adversely affect any other institution which may otherwise be subject to the Excise Tax. They will, however, serve to further the objectives of Code section 4968 and enable Berea and any other institution that might, in the future, use its endowment to make college education accessible and affordable to all of its students.

Just this week, Berea was #1 among the "Best Value Colleges" in the United States as rated by the annual Wall Street Journal/Times Higher Education College rankings. Berea is the only highly ranked value institution that does not collect any tuition from its students. Despite the economic and other hardships faced by our students, 49% of our 2019 senior class graduated with no debt. This is only possible because Berea's endowment is our tuition replacement fund that benefits every student. Any tax burden on this endowment is a direct impediment to Berea's mission and a disservice to our students who cannot afford to pay for college. We respectfully ask that Treasury Department and Internal Revenue Service take into account the full measure of Berea's different approach and adopt a definition of "tuition paying students" that is consistent with the purpose and text of Code section 4968 (b).

Sincerely,

BEREA COLLEGE

/s/ Robert T. Yahng, Chair, Board of Trustees

/s/ Lyle D. Roelofs, President

/s/ Jeffrey S. Amburgey, Vice President for Finance

/s/ Judge B. Wilson II, General Counsel